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No. 10-890

Supreme Court, U.S
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In The
Supreme Court of the United States

MIDLAND CENTRAL APPRAISAL DISTRICT,

Petitioner,

v.

BP AMERICA PRODUCTION CO., ET AL.,

Respondents.

On Petition For A Writ Of Certiorari To The Texas Court Of Appeals, Eleventh Appellate District

BRIEF OF AMICI CURIAE TEXAS ASSOCIATION OF SCHOOL BOARDS LEGAL ASSISTANCE FUND AND THE TEXAS MUNICIPAL LEAGUE IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

How does the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), apply to tangible personal property involved in commerce that is assessed a non-discriminatory ad valorem property tax:

- Is nexus, as the court below held, evaluated based on older "continuity of transit" cases exempting goods in the flow of commerce from paying their own way?
- Does nexus, as the court below held, also require a taxing authority to prove *in personam* "activity" by the taxpayer beyond the presence of the taxable *res* in the taxing jurisdiction?

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INTEREST OF AMICI CURIAE

The Texas Association of School Boards Legal Assistance Fund is an association of public school districts that plays a role in litigation likely to have a broad impact on its member districts.[1]

Those school districts have a particularly acute interest in the federal constitutional questions raised in this petition because the Texas school-funding system – like many local government entities across the country – depends on a local ad valorem property-tax system.

The brief is joined by The Texas Municipal League, which is a non-profit association of over 1090 incorporated cities that provides legislative, legal, and educational services to its members.

Continued uncertainty over how ad valorem taxes fit into the Commerce Clause framework makes it more difficult to shape the local tax policy that supports critical services.

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[1] No counsel for any party has authored this brief in whole or in part, nor has any entity other than the named amici curiae made a monetary contribution to the preparation or submission of the brief. *See* Sup. Ct. R. 37.5. Timely notice was given to all parties, and each gave written consent. *See* Sup. Ct. R. 37.2(a).

SUMMARY OF THE ARGUMENT[2]

There is now a split between two key states in the energy industry, Oklahoma and Texas, about what constitutional test applies to measure the taxability of oil and gas reserves under local ad valorem taxes.

Last Term, the Court had before it a petition challenging Oklahoma's side of the split. The Court called for the views of the Solicitor General, who expressed the view that Oklahoma had the better side of the argument and that, in any event, the Texas courts had not yet spoken with finality. Now they have, and there is no reason to delay this Court's review. A split between sister states about the federal law governing goods in transit deserves attention.[3]

The court of appeals embraced a "continuity of transit" test dating from a time when this Court had held that interstate commerce was by its nature exempt from state taxes. That test does not shed light on the modern *Complete Auto* framework, and importing it into the nexus prong threatens significant

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[2] This amicus brief is being submitted in support of this petition and in support of *Harrison Central Appraisal District v. Peoples Gas, Light and Coke Co.*, No. 10-896, both of which raise the same constitutional issues. When necessary for clarity, the present petition is referenced as the "*Midland* case" in contrast to the "*Harrison* case."

[3] Federal circuits generally do not hear challenges to state ad valorem taxes because of the Tax Injunction Act. 28 U.S.C. §1341.

damage to ad valorem property tax rolls, shifting the burden onto domestic taxpayers and, in effect, discriminating against intrastate commerce.

Further, the court of appeals adopted a legally incorrect view of how nexus should be tested for ad valorem property taxes. The court held that substantial nexus under *Complete Auto* requires a showing of *in personam* ("activity") contacts by the taxpayer rather than contact with the taxable *res*.

These petitions frame the problem well, and their contrasting facts offer a good vehicle to test the rule. Until this Court resolves these foundational questions under *Complete Auto*, both industry and taxing authorities will be wandering in the fog of Nineteenth Century "continuity of transit" case law that ill fits the modern economy and results in sharply disparate treatment of different industries based on features unrelated to the constitutional principles underpinning the Commerce Clause.

ARGUMENT

I. There Is an Entrenched Split About How the *Complete Auto* Framework Applies To Goods in Transit, Including Gas and Oil.

A. A split between Texas and Oklahoma that affects energy has broad importance.

Texas and Oklahoma have split on a question of constitutional law that creates uncertainty for the energy industry and local governments alike. The affected states are central to the national energy industry both in geography and geology.[4]

As things stand, when oil or gas flows through pipelines that cross the Red River, it leaves one view of federal law (Texas' more expansive one that shields the goods from taxes) and encounters a polar opposite view of federal law (which permits nondiscriminatory local taxes).

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[4] In arguing for certiorari in *Missouri Gas*, the American Gas Association pointed to a helpful Department of Energy map showing the web of gas pipelines across the lower 48 states. *See* Amicus Brief of American Gas Association, *Missouri Gas v. Schmidt* (No. 08-1458), at 17 & 3a (map). That map remains the most current on the Department's website. *See* "Interstate Natural Gas Supply Dependency, 2007," http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/dependstates_map.html (visited Feb 6, 2010). In addition to the network of interstate pipelines, it highlights 30 states that "are at least 85% dependent" on the network for natural gas from producing states such as Texas and Oklahoma. *Id.*

Consider, for example, the newly tapped Barnett Shale, which is centered just below the Red River on the Texas side of the border. Should any of this gas be sent to a storage facility north of the Red River, it can be taxed; on the south side of the Red River, it is given complete federal immunity from taxation.

The split also touches neighboring states on the interstate pipeline system.[5] For example, Louisiana courts continue to apply the older "continuity of transit" analysis when determining whether goods can be assessed an ad valorem tax.[6] Formally, they apply state enactments made when "in transit" was prevailing federal law.[7] But with the present split of authority and without guidance from this Court, Louisiana policymakers do not know what latitude they have to loosen those restrictions over local ad valorem taxation.

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[5] For one example of how pipelines cut across these neighboring states, look at the pipeline in *Missouri Gas*. One of its two branches begins in Texas and runs through Oklahoma to Kansas, where it has a storage facility before reaching its endpoint *Missouri Gas*, 234 P3d at 944 The other begins in Oklahoma, where it has a storage facility, and then merges together with the endpoint in Kansas. *Id.*

[6] *E.g.*, *Mississippi River Transmission Corp. v. Simonton*, 442 So. 2d 764, 770 (La. Ct. App. 1983).

[7] *Id.* at 770.

B. The split is firm and will not resolve itself.

The petitions now before the Court attack two Texas decisions that, serendipitously, came down as bookends around the Oklahoma Supreme Court's decision in *Missouri Gas*, one before and one after. Both states were aware of the split and further entrenched their conflicting positions.

The Oklahoma court noted the first Texas decision in conflict with its holding. *In re Assessment of Personal Prop. Taxes Against Mo. Gas Energy*, 234 P.2d 938, 959-60 (Okla. 2008). And it expressed its disagreement in no uncertain terms:

> [W]e remain unpersuaded by that court's reasoning. The Texas court first scrutinizes Harrison County's ad valorem tax using the traditional continuity of transit analysis, **a test we reject today as having been superseded** by the Supreme Court's decision in *Complete Auto Transit v. Brady*. . . .
>
> In addition, **we decline to follow the Texas court's reasoning** in concluding that the ad valorem taxation of storage of gas fails to meet the first and fourth prongs of the *Brady* test. . . .
>
> We are convinced that **the Texas court's focus on the parties' activities and their *in personam* types of contacts with the taxing state is mistaken.** The tax at issue is an ad valorem property tax, a tax on

> property where it is located, not on the taxpayer's activities.

Id. at 959-60 n.84 (emphasis added) (discussing *Harrison Cent. Appraisal Dist. v. Peoples Gas, Light & Coke Co.*, 270 S.W.3d 208 (Tex. App. – Texarkana 2008, pet. denied)). With only one justice dissenting, Oklahoma's position is firm.

Nor has Texas budged. At the time of the Oklahoma decision, the *Harrison* opinion it so harshly criticized was pending rehearing in the court of appeals. After supplemental briefing by both sides, that court left intact its opinion, cementing the split.[8]

And when the *Midland* opinion was issued, it even more explicitly rejected the core holding of the Oklahoma case – that the old "in transit" line of cases had been superseded by *Complete Auto*. Instead, it rested its decision on that very quicksand – reliance on the old continuity of transit analysis and looking for *in personam* contacts to support an ad valorem property tax.[9] *Midland Cent. Appraisal Dist. v. BP*

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[8] The *Harrison* opinion was issued on September 24, 2008. The Oklahoma opinion was issued on October 21, 2008. A letter brief was filed with the *Harrison* court on November 3, 2008, and a response was filed a few weeks later. The *Harrison* court denied rehearing on December 9, 2008. (Docket information for this case is available at the court website, http://www.6thcoa.courts.state.tx.us, using the "Case Search" feature and the docket number "06-07-00103-CV".)

[9] Indeed, when the *Midland* court sought to distinguish the facts from the Oklahoma case, it invoked the "in transit" reasoning that the Oklahoma court had rejected. *Midland*, 282 S.W.3d

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Am. Prod. Co., 282 S.W.3d 215, 221-23 (Tex. App. – Eastland, pet. denied) (analyzing continuity of transit); *id.* at 223-24 (using "in transit" to substitute for a nexus analysis); *id.* at 224 (looking for *in personam* contacts by the owner while discounting the property's connection to the taxing jurisdiction).

Through borrowing rigid, formalistic "in transit" precedents, *Harrison* and *Midland* have rejected the pragmatic approach to the Dormant Commerce Clause recognized in *Complete Auto*. The Texas Supreme Court's denial of review in these two petitions confirms that the split will not resolve itself.

C. Using older cases to inform the nexus analysis distorts the *Complete Auto* framework and warrants certiorari.

The *Complete Auto* test is this Court's general framework for analyzing taxes under the Dormant Commerce Clause. *Complete Auto* closed a schism between older cases presuming that states inherently lacked authority over interstate commerce and others holding that interstate commerce could be made to "pay its way." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 284 (1977). It reaffirmed that there was

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at 224 ("The crude oil in the present case was not in storage but, rather, was in transit in the stream of interstate commerce."); *cf. Missouri Gas*, 234 P.3d at 955 ("Were the court making the old 'in transit' or 'at rest' determination, this record would make that determination very difficult.").

no "free trade" immunity from taxes on interstate commerce, *id.* at 278-79, and instead that taxes were permitted if they met the four requirements later termed the *Complete Auto* test, *id.* at 279.

Since 1977, that framework has been applied to many state and local taxes and regulations. The Court has developed a sophisticated set of tools for measuring discriminatory effect.

But the Court has given little guidance about how to interpret the first prong of *Complete Auto* – the "substantial nexus" prong. As a result, the lower courts are floundering. The *Harrison* and *Midland* courts' approach of using older cases to inform this analysis subverts *Complete Auto* by carving out an antique, Nineteenth Century "free trade" immunity for commerce. Just as anachronistically, these "in transit" cases embed into their analysis assumptions about what discrimination is or is not permissible – creating tension with the more evolved modern versions of the second and third prong of *Complete Auto*.[10]

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[10] For example, *Midland* justifies its adherence to the "in transit" test by noting that, otherwise, multiple states might have jurisdiction over the goods at some point in their journey *Midland*, 282 S W.3d at 224 (citing *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S 157, 170 (1954)). But under *Complete Auto*, the second and third prongs address any multiple-taxation concern directly, there is no need to overload the first prong, which is simply the wrong tool *E.g., Oklahoma Tax Comm'n v Jefferson Lines, Inc* , 514 U S 175, 184 (1995).

This tension between the framework used in the older cases such as *Minnesota v. Blasius*, 290 U.S. 1, 9-10 (1933) (goods in the flow of interstate commerce have "immunity . . . from state taxation"), and the *Complete Auto* framework goes back to first principles. The continuity-of-transit cases are looking for a hook to divest states of jurisdiction – movement in commerce – by elevating the goods into a special realm of federal immunity. If that hook is imported into the nexus prong of *Complete Auto*, it would sap all the flexibility and nuance from the modern test.

II. These Decisions Reflect an Untenable View of *Complete Auto*.

The Texas courts have made two related mistakes about a single prong of the *Complete Auto* test: (1) looking to whether the oil or gas was "in transit" as a measure for substantial nexus with the state and (2) framing nexus as whether the taxpayer had other "activity" in the state beyond ownership of the taxable *res*.

A. The "in transit" authorities presuppose immunity from taxation in which interstate commerce does not pay its own way.

The Texas courts focused extensively on whether the gas or oil would be considered "in transit" – and did so by invoking cases built on the pre-*Complete Auto* idea that interstate commerce was immune from

taxation. *See Harrison*, 270 S.W.3d at 215-17 (in holding the gas was "in transit," relying on Supreme Court constitutional cases from 1886, 1922, 1926, 1929, 1933, 1947, and 1954); *Midland*, 282 S.W.3d at 221-23 (adding a case from 1921).[11]

Those cases presuppose an absolute immunity of interstate commerce from state taxing authority. *E.g.*, *Blasius*, 290 U.S. at 9-10 (continuous movement creates "immunity of the property from state taxation"); *Champlain Realty*, 260 U.S. at 276 (discussing "the immunity from state taxation [of] things actually in interstate commerce").

And that stands in tension with *Complete Auto*, which acknowledged a shift away from the constitutional understanding within which those pre-*Complete Auto* cases were decided. For that reason, they do not meaningfully inform a proper evaluation of "substantial nexus" under the modern *Complete Auto* test.

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[11] *Michigan-Wisconsin Pipe Line Co v. Calvert*, 347 U.S. 157 (1954); *Indep. Warehouses v. Scheele*, 331 U.S 70 (1947); *Minnesota v Blasius*, 290 U.S. 1 (1933); *Carson Petroleum Co. v. Vial*, 279 U.S. 95 (1929); *Hughes Bros. Timber Co. v Minnesota*, 272 U.S. 469 (1926); *Champlain Realty Co v. Town of Brattleboro*, 260 U.S. 366 (1922); *Eureka Pipe Line Co. v. Hallanan*, 257 U.S. 265 (1921); *Coe v Errol*, 116 U.S. 517 (1886).

1. "In transit" does not fit *Complete Auto*.

The historical understanding of "in transit" cannot be imported wholesale into *Complete Auto*'s nexus prong without displacing the rest of the test. The Court stated its goal to have a "standard of permissibility of state taxation based upon its actual effect rather than its legal terminology." *Complete Auto*, 430 U.S. at 281. A return to "in transit" is a step backwards and would serve "only to distract the courts and parties from their inquiry into whether the challenged tax produced results forbidden by the Commerce Clause." *Id.* at 285.

Reviving the "in transit" test also brings back the *Spector* philosophy that "interstate commerce should enjoy a sort of 'free trade' immunity from state taxation." *Complete Auto*, 430 U.S. at 278 (discussing *Spector Motor Serv. v. O'Connor*, 340 U.S. 602 (1951)). *Complete Auto* should have dispelled those ghosts of constitutional history. Under its four-prong test, "interstate commerce may be made to pay its way." *Complete Auto*, 430 U.S. at 284-85.

2. "In transit" unduly penalizes competing intrastate commerce and would distort the market.

Natural gas, to use the example provided by the *Harrison* case, is a market where the "in transit" test would put a thumb on the free-market balance between local (intrastate) and distant (interstate)

options.[12] If storage facilities along *interstate* pipelines have a federal immunity to local tax, they will have a pricing advantage over nearby sources of gas.

The Dormant Commerce Clause should level the field for interstate commerce, not award it an unearned edge in the marketplace. The market distortion caused by this holding strongly suggests that the formalistic "in transit" rule has broken with the reality of the modern economy.

B. For ad valorem property taxes, nexus should be measured against the goods, not the taxpayer.

The court of appeals based its nexus holding on a wrongly framed legal test. Instead of asking whether the goods themselves had a sufficient nexus with Texas to support a nondiscriminatory tax, it instead asked whether the taxpayer had some other *in personam* contacts beyond ownership of the goods.

The court described this as a search for some other "activity" by the nominal owner of the oil within the borders of the state. *Midland*, 282 S.W.3d at 224.

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[12] Texas, for example, has a substantial network of purely intrastate natural-gas pipelines. *See* "Intrastate Natural Gas Segment," http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/intrastate.html (visited Feb. 8, 2010) ("Intrastate pipelines in Texas account for 45,000 of the 58,600 miles of natural gas pipelines in the state.")

In a functionally similar test, *Harrison* looked for whether the taxpayer had some "personal presence" within the state beyond the presence of the natural gas. *Harrison*, 270 S.W.3d at 218. These formulations became central to each court's holding under the nexus prong.[13]

In one of the Court's few statements on the nexus prong of *Complete Auto*, it borrowed a due-process formulation saying that a tax requires substantial nexus "between a state and the person, property, or transaction it seeks to tax." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954)). Before *Complete Auto*, the Court had stated how local ad valorem taxes can be imposed on local property: "Of course, the situs of property may tax it regardless of the citizenship, domicile, or residence of the owner." *Miller Bros.*, 347 U.S. at 345.

But the Court has not yet spoken so plainly about how the Commerce Clause gauges nexus over these same ad valorem taxes after *Complete Auto*.

In the absence of specific guidance, the lower courts now disagree about what test to use for nexus. Oklahoma looks for nexus with the property.

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[13] The court of appeals acknowledged, "the oil itself had a substantial nexus with this state." 282 S.W.3d at 224. And *Harrison* noted that "[i]f one were to look strictly at the generic act of storing gas . . . it might appear that such an activity would have a substantial nexus with the State." 270 S.W.3d at 218.

Missouri Gas, 234 P.3d at 955 (looking to the presence of the gas, not the taxpayer, within the state). But the Texas courts have looked for nexus with some "activity" of the out-of-state owner of the property being taxed. *Midland*, 282 S.W.3d at 224; *Harrison*, 270 S.W.3d at 218.

Looking to nexus with the owner's "activities" would lead to bizarre results for local governments who depend on ad valorem property tax. For these local taxing jurisdictions, marshaling such proof may be a challenge. Nor does distinguishing between taxable property based on whether its owner happens to have *other* activities or property nearby further the constitutional values underpinning the Commerce Clause. The Court should clearly state that nexus for ad valorem property taxes should be measured against the property being taxed, not its owner.

III. Both Petitions Warrant Attention.

With *Harrison* and *Midland*, the Court can choose between two petitions raising the same constitutional issue. In the Texas Supreme Court, these two cases were briefed in parallel and treated by the parties as intertwined.

The Court should consider taking the petitions as a pair. Failing that, it should grant a lead petition and, ultimately, vacate and remand the other.

A. The petitions offer contrasting facts that could yield a more satisfying rule than either alone.

Although both petitions involve products of the energy industry, the fact patterns differ in ways that bear on the older "in transit" analysis. As a pair, they may offer a more satisfying way to announce a rule than any single, later petition is likely to do:

(1) The *Harrison CAD v. Peoples Gas* petition presents a classic case of natural gas storage facilities, akin to a warehouse for goods. This should have passed muster even under the old "in transit" cases because the gas was stored for business reasons, such as shifting supply to meet seasonal variations in market demand.

(2) The *Midland CAD v. BP America* petition presents something more akin to a cross-dock for goods, where some oil barely pauses and other oil is subjected to "batching," "blending," and "staging" for different purposes and lasting different periods of time.[14] Although the better holding is that taxing this property satisfies *Complete Auto*, this is a closer case.

By taking this set of petitions, the Court can announce a rule that deals both with goods arguably

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[14] Even under a strict "in transit" analysis, some of these operations might interrupt the continuity of transit. For example, "blending" combines fuel with different characteristics to make a more marketable product than its original components.

"in transit" under pre-*Complete Auto* jurisprudence (such as oil in the *Midland* tank farm) and goods that are plainly "in storage" under that view (such as the gas in *Harrison*). Addressing both at once is the surest way to remove the confusion over how, if at all, these concepts fit under *Complete Auto*.

B. At a minimum, this petition should be held for an eventual GVR.

1. A GVR would ensure that the court of appeals applies the correct rule.

The *Midland* opinion directly discussed *Harrison*, concluding that the facts in its own case "present[ ] an even stronger case for a Commerce Clause violation than did the circumstances in [*Harrison*]." 282 S.W.3d at 223-24.

The reason? Its reading of pre-*Complete Auto* cases about whether goods are "in transit." *Id.* at 221-22 (citing no federal cases from after 1933); *id.* at 224 (citing "in transit" as key to nexus). If the Court grants review in *Harrison* and ultimately (and correctly) reverses, then a vacatur and remand of *Midland* would permit it to apply the modern test.

2. There is little doubt that the Court has jurisdiction.

The *Midland* opinion discusses a provision of Texas law that asks if the property being taxed was

present "for more than a temporary period." TEX. TAX CODE §21.02(a)(1); *Midland*, 282 S.W.3d at 224. Without referencing any state case law – and without even offering a construction of the statutory text – the opinion pointed back to its much more extensive discussion of federal law ("[a]s discussed above") to explain how it applied state law. *Id.* at 224-25.

As a threshold matter, a state-law ground only affects this Court's jurisdiction if its independence is "clear from the face of the opinion." *Michigan v. Long*, 463 U.S. 1032, 1040 (1983). Nowhere does the opinion state that this was an *independent* question of state law. Nor does it say that the scope of the Texas statute ("more than a temporary period") in any way departs from federal constitutional constraints. Instead of an independent state-law analysis, the opinion cross-referenced its federal holding. *Midland*, 282 S.W.3d at 224.

Second, the Court has jurisdiction whenever "a state court's interpretation of state law has been influenced by an accompanying interpretation of federal law." *Three Affiliated Tribes of Fort Berthold Reservation v. Wold Eng'g, P.C.*, 467 U.S. 138, 152 (1984). Federal law, including an extensive discussion of whether the oil was "in transit" under pre-*Complete Auto* precedents, 282 S.W.3d 221-22, drove the outcome here.

Third, although the presumptions of *Michigan v. Long* make further inquiry unnecessary, this area of

Texas law is in fact deeply "interwoven" with federal law. *Id.* at 1040.

That's because Texas pushes its taxing jurisdiction over tangible personal property to the constitutional limit; only those exemptions spelled out in the state constitution or required by conflicting federal law are permitted; mere state statutes cannot authorize exemptions.[15] *Appraisal Review Bd. v. Tex-Air Helicopters, Inc.*, 970 S.W.2d 530, 534 (Tex. 1998) (holding that another portion of this statute was permissible as "an attempt to comply with United States constitutional mandates").[16]

When a state has bound itself to an unduly limiting view of federal constraints – when driven by "what it understood to be federal constitutional considerations to construe and apply its own law in

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[15] TEX. CONST. art. VIII, §1(b) ("All real and personal property in this State, unless exempt as required or permitted by this Constitution . . shall be taxed in proportion to its value") No party has argued that these goods are exempt under any *state* constitutional provision. The only possible source of exemption is federal law

[16] In cases involving state constitutional rights, Texas courts have been instructed to make clear whenever they rely on a presumed deviation between state and federal law. *Davenport v. Garcia*, 834 S.W 2d 4, 20 (Tex. 1992) (an opinion should, if appropriate, "provide a 'plain statement' that it is relying on independent and adequate state law"). The *Midland* court did not There is no state constitutional exemption at issue here; only federal exemptions could apply

the manner it did," *Zacchini v. Scripps-Howard Broad. Co.*, 433 U.S. 562, 568 (1977) – this Court is in a unique position to protect the balance of federalism by granting review.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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